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Safeguarding
the sustainability
of the Ukrainian pension
system

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Viktoriiia Klimchuk**

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OECD Economics Department Working Papers

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ABSTRACT**Safeguarding the sustainability of the Ukrainian pension system**

Before Russia's full-scale invasion of Ukraine, the Ukrainian Pay-As-You-Go pension system required large government transfers. Since then, large scale emigration and an increasing number of people eligible for pensions have further increased the need for government transfers and exacerbated the challenges of population ageing. At the same time, the system provides relatively low pension benefits, despite fairly high contribution rates and short time in retirement. This reflects to a large degree a relatively narrow contribution base due to a large informal economy and underreporting of labour income. Reform of the system must encourage participation, secure liveable pensions, and safeguard the system's fiscal sustainability.

JEL codes: E6, H55, I32, J46

Public finances, pension systems, old-age poverty, informal labour markets

RÉSUMÉ**Préserver la viabilité du système de retraite ukrainien**

Avant l'invasion à grande échelle de l'Ukraine par la Russie, le système ukrainien de retraite par répartition nécessitait d'importants transferts gouvernementaux. Depuis lors, l'émigration à grande échelle et l'augmentation du nombre de personnes pouvant prétendre à une pension ont encore accru le besoin de transferts publics et exacerbé les problèmes liés au vieillissement de la population. Dans le même temps, le système prévoit des prestations de retraite relativement faibles, malgré des taux de cotisation assez élevés et une durée de retraite courte. Cette situation reflète dans une large mesure une base de cotisation relativement étroite, due à l'importance de l'économie informelle et à la sous-déclaration des revenus du travail. La réforme du système doit encourager la participation, garantir des pensions viables et préserver la viabilité budgétaire du système.

Codes JEL : E6, H55, I32, J46

Finances publiques, systèmes de pension, pauvreté des personnes âgées, marchés du travail informels

Table of contents

1 Safeguarding the sustainability of the Ukrainian pension system	5
Introduction	6
Benefit adequacy and fiscal sustainability of the pension system are at risk	6
The contribution base is narrow	6
Despite a low pension age, time spent in retirement is short	8
Contribution periods are short and accrual rates are low	9
The contribution rate is fairly high	11
Pension benefits are low	11
Special pension regimes are numerous and underfunded	13
Access to the disability pension system is cumbersome	16
The pension system's deficit is set to increase substantially	17
Policy reform options	19
Policy options for safeguarding the pension system:	20
Bibliography	21
Tables	
Table 1. Special and other pension regimes have high enrolment, 2023	14
Table 2. Occupational scope of pension provisions for hazardous or arduous jobs in OECD countries	15
Figures	
Figure 1. An ageing population is increasing the old-age dependency ratio	7
Figure 2. The statutory retirement age and effective labour market exit age are low	8
Figure 3. Life expectancy and expected years in retirement after labour market exit are low	9
Figure 4. The net pension replacement rate is low	10
Figure 5. The contribution rate is relatively high	11
Figure 6. Pension benefits are low	12
Figure 7. Most pensioners receive benefits that are well below the minimum wage	13
Figure 8. The Pension Fund needs large transfers from the state budget	18
Figure 9. The deficit in the pension system is set to widen	19
Box	
Box 1. International experience in managing pension challenges in a post-war context	17

1 Safeguarding the sustainability of the Ukrainian pension system

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Introduction

The Ukrainian pension system is a Pay-As-You-Go (PAYG) system, where current contributions finance current pensioners' benefits. Already prior to Russia's full-scale invasion of Ukraine, the system was in deficit – a situation that was set to deteriorate with population ageing. The deficit mostly reflects that a low effective retirement age, and a low number of contributors that more than offsets the budgetary effects of relatively low benefits. The system covers all wage earners and self-employed workers. However, the low number of contributors reflects a large informal economy and underreporting of income, particularly among the self-employed. The war has made the situation worse. The contribution base has shrunk as large numbers of people have left the country and the number of beneficiaries is set to increase, particularly in the disability pension scheme. Low benefits pose an additional adequacy challenge, with a high occurrence of old-age poverty.

Benefit adequacy and fiscal sustainability of the pension system are at risk

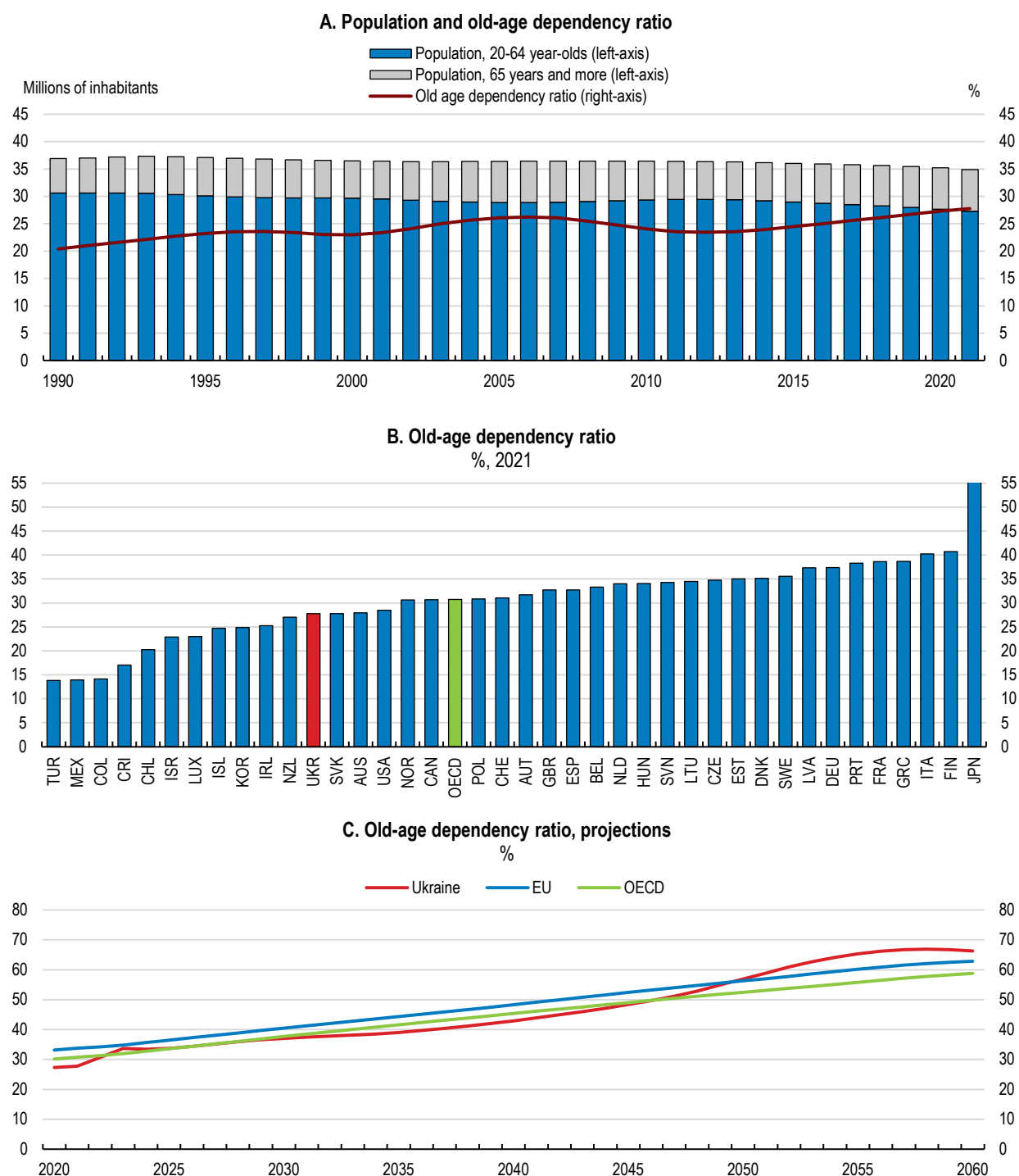
The contribution base is narrow

The public pension system is organised around the Pension Fund, which is responsible for distributing benefits, including for old-age, survivors, and disability pensions. Contributions are mainly collected by the tax authority as the fund is only responsible for collecting a mandatory state pension insurance fee from certain types of business transactions. The PAYG system has a solidarity element in the sense that current contributors are paying the benefits for current pensioners. However, the pension fund does not accumulate, preserve, or invest capital, reducing solidarity between generations. Thus, the system is dependent on the number of participants, amounting to 21.5 million people in 2022, of which 10.7 million are pensioners. This is some 5 percentage points more than the population above the statutory pension age of 60 years, reflecting low retirement ages and good coverage as most have access at least to a minimum pension. In contrast, there are only 10.8 million contributors, which represent 39% of the population aged 15-64 years.

The low contribution base reflects a relatively large informal economy, which is estimated to account for one-fifth of all employment. In addition, many employers and self-employed workers only pay contributions based on the minimum wage. Indeed, incentives to contribute to the pension system are limited: there is only a weak link between contributions paid and benefits received, and nearly two-thirds of all pensioners receive a pension that is below the minimum wage. As a result, higher income workers receive relatively lower pension benefits than lower income workers, reflecting that the solidarity component in the system is larger than the insurance component.

The near equality between the numbers of pensioners and contributors is unusual when compared with OECD countries, where the number of contributors tends to be higher than the number of pensioners. While the old-age dependency ratio is below the OECD average, it is increasing, as the working age population is falling (Figure 1). However, unlike the OECD countries, the older population (plus 60 years) is also shrinking. Before the war, the old-age dependency ratio was projected by the UN to rise from a relatively low level (Figure 1, panel C). The war is likely to have accelerated that process (see below).

Figure 1. An ageing population is increasing the old-age dependency ratio



Note: The old-age to working-age demographic ratio is defined as the number of individuals aged 65 and over per 100 people of working age defined as those at ages 20 to 64. In all countries, the evolution of old-age to working-age ratios depends on mortality rates, fertility rates and migration. Projections are based on the "Medium scenario" of the UN World Population Prospects. Source: UN World Population Prospects 2022.

Despite a low pension age, time spent in retirement is short

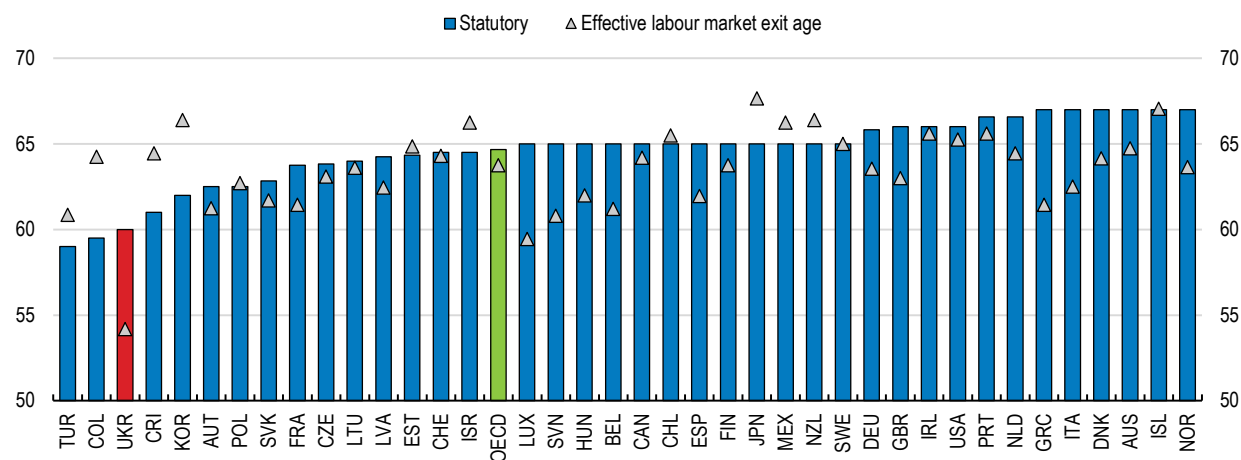
A contributing factor to the high number of pensioners is a low statutory retirement age of 60 years for both men and women (although incomplete contribution periods can entail a higher retirement age, see below). This is at least 5 years less than in most OECD countries (Figure 2). The effective retirement age, which include all routes to retirement (such as unemployment and sickness leave) has not been calculated for Ukraine due to a lack of data, but the observed retirement age is relatively low compared with the effective retirement age in OECD countries (Figure 2). As life expectancy at age 60 is relatively low (at 69.8 years in 2021), the average time spent in retirement is fairly short, despite the low retirement age (Figure 3).

Life expectancy at age 60 is relatively low but with large gender differences, as life expectancy of women was 74.4 years in 2021, nearly a decade longer than that of men – a life expectancy difference that is larger than in most OECD countries (Figure 3). With the same retirement age for men and women, this means that women spend considerably more time in retirement than men. Moreover, the higher life expectancy in the OECD countries means that time spent in retirement is higher in almost all OECD countries.

Since 2019, there has been a shift towards later retirement. Over 2019-2023, the share of people retiring before age 60 has dropped from 25 % to 11%, while the number of people leaving after 60 has increased from ½ % to 14%, although still few retire at or after age 65. This mainly reflects that in 2017 women's mandatory retirement was increased by 5 years to equal that of men. Additional factors may include to tax initiatives for encouraging workers to remain on the labour market (see below), although the war can have induced older workers to remain on the labour market as younger workers were drafted into the army.

Figure 2. The statutory retirement age and effective labour market exit age are low

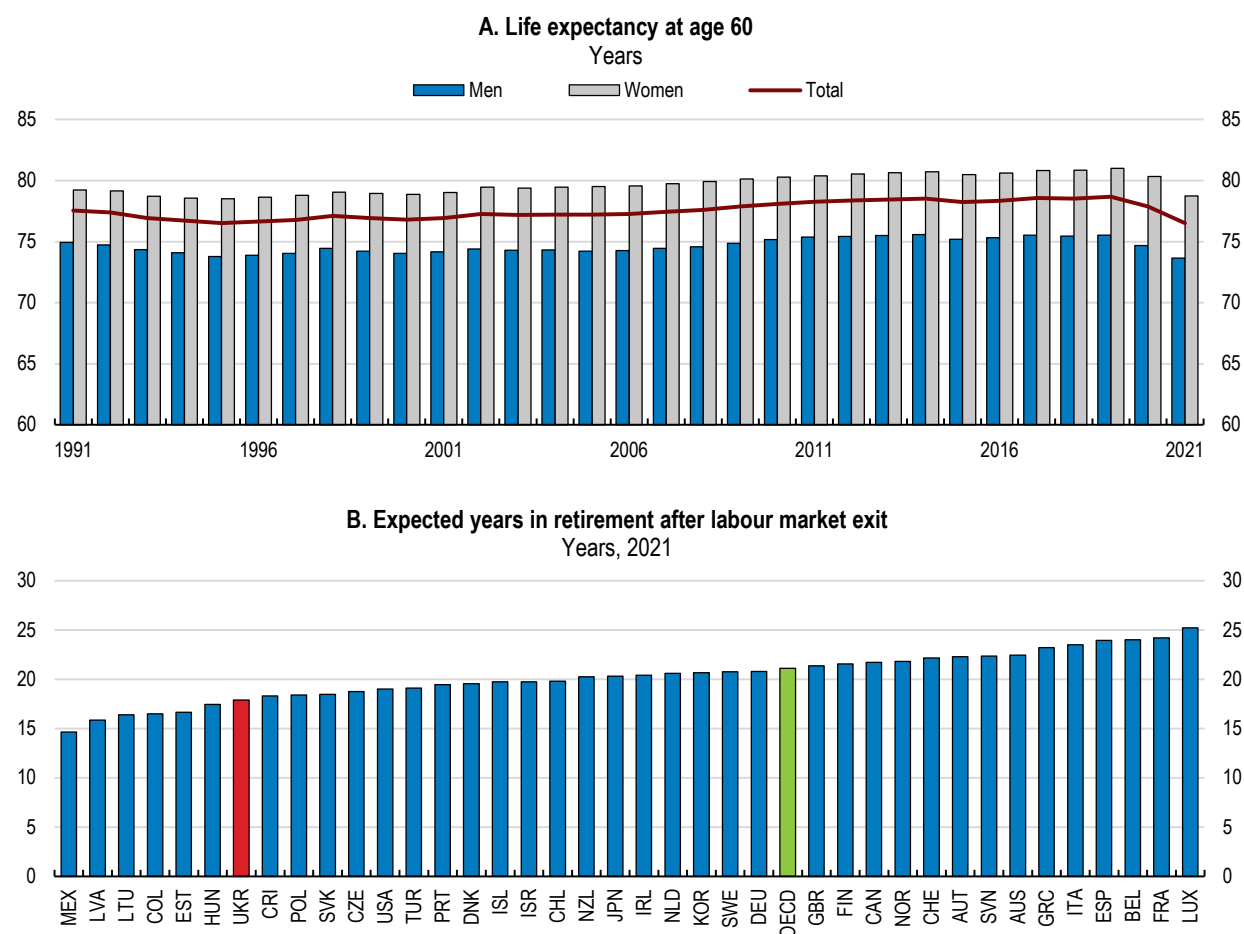
Retirement age, 2022



Note: For Ukraine, the effective retirement age could not be calculated, therefore the observed age of retirement is used in the Figure.

Source: State Statistics Service of Ukraine; and OECD (2023) Pension at a Glance 2023.

Figure 3. Life expectancy and expected years in retirement after labour market exit are low



Source: State Statistics Service of Ukraine; and OECD Pension Statistics database.

Contribution periods are short and accrual rates are low

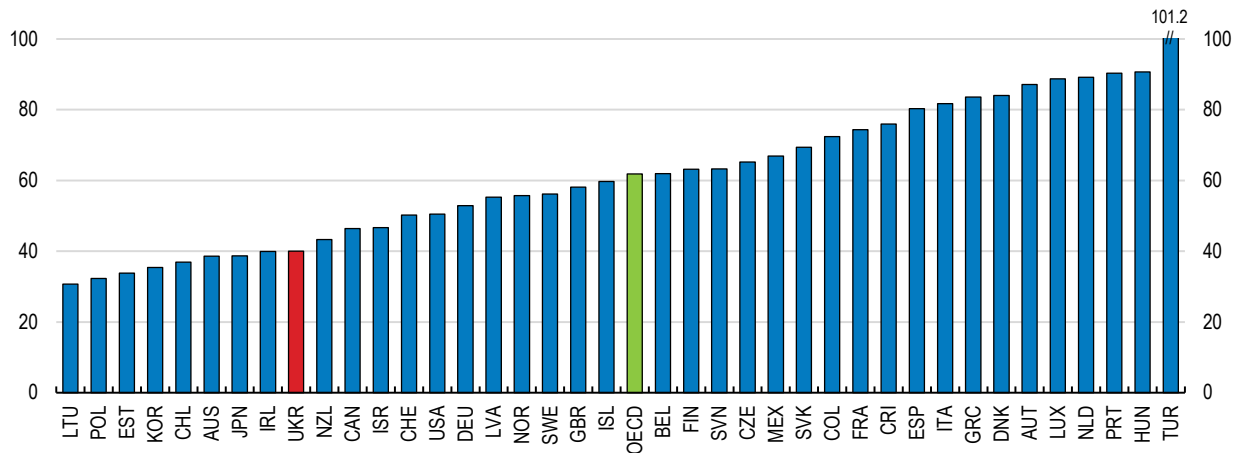
To receive a full pension, 30 years of contributions are needed. A 2017 pension reform is increasing the contribution period gradually to 35 years by 2028, bringing the contribution period closer to those prevailing in the OECD countries. In case a full contribution period is not reached at age 60, the retirement age increases to 63 (or 65). People with shorter contribution periods are entitled to social assistance, reducing contribution incentives. From 2028, 40 years of contribution will be sufficient to retire irrespective of age, enabling some workers to stop working before the statutory retirement age. In comparison, most OECD countries have moved away from using contribution periods as a main retirement access condition to an age-specific condition.

Pension benefits are calculated based on an accrual rate of 1 percentage point per year (1.35% until 2018), so a 40-year contribution period entails benefits equal to 40% of a calculated wage that takes into account career income and the average wage in Ukraine over the preceding three years, leading to a replacement rate that is lower than in most OECD countries (Figure 4) (International Labour Organization, 2019^[1]). Benefits are not subject to personal income tax. In contrast, benefits in OECD countries are typically subject to personal income taxes, and are often taxed less than wage income as pensions in many cases are subject to reduced social security contributions. Continued work is encouraged with an accrual rate of 6% per year for people working after reaching the official pension age, calculated as an additional 0.5 per cent for each extra month of contribution and increasing to 0.75 per cent after 5 years (International Labour Organization, 2019^[1]). For those who continue to work after the statutory retirement age, the accrual rates

are larger than those found in most OECD countries and are likely to have contributed to the increasing share of workers that remain on the labour market after the age of 60.

Figure 4. The net pension replacement rate is low

Net pension replacement rate, %, 2020



Note: The net replacement rate is defined as the individual net pension entitlement divided by net pre-retirement earnings, taking into account personal income taxes and social security contributions paid by workers and pensioners. It measures how effectively a pension system provides a retirement income to replace earnings, the main source of income before retirement. This indicator is measured in percentage of pre-retirement earnings.

Source: State Statistics Service of Ukraine; and OECD Pension Statistics database.

The calculation of the contribution period includes periods of maternity and child leave, caring for disabled or elderly persons, unemployment, military service and work-related sickness. There are no contributions for unemployed persons not registered with the public employment service. This group accounts for 75 per cent of all unemployed persons, which may be related to the relatively low unemployment benefits, particularly for workers with short work careers. A consequence is that most unemployed persons have no pension contributions made during unemployment spells (International Labour Organization, 2019^[1]). Moreover, years in the contribution period are doubled for work in difficult or dangerous conditions (according to a pre-defined list of occupations). As the contribution rate remains unchanged at 22%, this is leading to an underfunding of the system that is covered by the state budget.

The few gender differences in the pension system are in the contribution period required for obtaining the minimum pension, where men qualify for a minimum pension after 35 years of contributions, while the requirement for women is 30 years. Similarly, for workers with disabilities the contribution period to qualify for a minimum pension (see below) is five years shorter for women than for men. In addition, mothers with at least five children or disabled children can retire at the age of 50 with 15 years of contributions, while fathers in these cases need to be 55 and have 20 years of contributions. Such gender differences tend to discourage female employment and leave women with less adequate pensions. Most OECD countries are therefore removing such gender differences.

The technicalities behind the calculated wage mean that it is difficult for contributors to calculate their future benefits. This reflects that electronic personalised accounting has only been in place since 2000. Nonetheless, this leads to a lack of transparency in the system. In many OECD countries, including Australia, Denmark, Estonia, France, Latvia, Netherlands and Sweden, such issues have been addressed by creating pension monitors to give future pensioners information about their benefits under different career assumptions. Almost all OECD countries provide on-line information about public pensions, and many also for private pensions (OECD, 2016^[2]). Surveys in Italy, Sweden and the UK indicate that most users find calculators and monitors useful for improving their understanding of their pension rights (OECD,

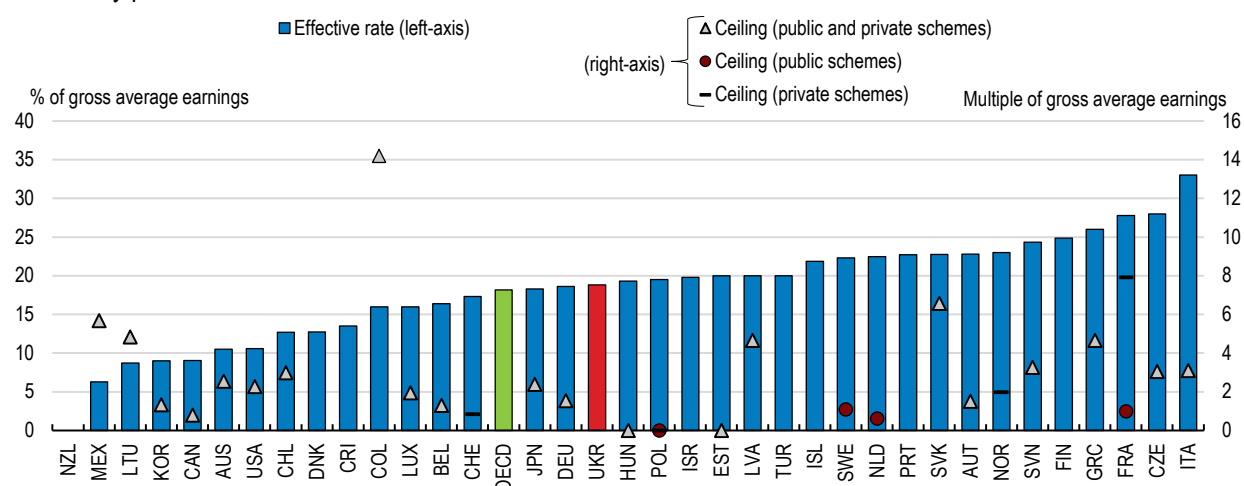
2020₍₃₎). Ukraine has an online pension calculator, but it still relies on a relatively high degree of self-reporting and could be made more user-friendly.

The contribution rate is fairly high

The social security contribution, known as the Single Social Contribution, is at a rate of 22% and is payable by the employer. A bit more than 85 per cent of the contribution is directed to the pension system, leading to an effective pension contribution rate of 18.8%. This reliance on employer contribution is uncommon in the OECD countries, where the norm is that both employees and employers contribute to the pension system. Indeed, the lack of an employee contribution creates incentives for informality. The nearly 19% rate is relatively high and even more so in effective terms, as most OECD countries have ceilings on contributions that are lower than those in Ukraine (Figure 5). Self-employed workers pay the same social security rate on their taxable income. In both cases, there is an upper cap of UAH 100500 (equal to 15 times the minimum wage). This ceiling is so high that it is effective for very few contributors (International Labour Organization, 2019₍₁₎). Moreover, the state pays contributions in a number of cases, such as periods of military service, adding to fiscal pressures in the war economy, and parental leave (up to 3 years) (International Labour Organization, 2019₍₁₎).

Figure 5. The contribution rate is relatively high

Mandatory pension contribution rates, 2022



Note: The ceiling in Ukraine only affects few very high-income workers. For other countries where a marker is absent in the graph, a ceiling does not exist.

Source: OECD (2023), Pensions at a Glance 2023: OECD and G20 Indicators, OECD Publishing, Paris, <https://doi.org/10.1787/678055dd-en>; and State Statistics Service of Ukraine.

Pension benefits are low

Benefits are low and the average pension is well below the minimum wage (Figure 6). In addition, almost all pensioners receive a pension that is below the minimum wage and nearly half of all pensioners receive a pension that is around or lower than the subsistence level (Figure 7).

Despite different floors for pension benefits, pension adequacy remains an issue:

- The minimum pension is below the subsistence level for people with full working capacity (a lower level is in place for people who have lost their working capacity). The lower level for the minimum pension is that since 2027, it cannot be below the subsistence minimum for disabled persons.
- The floor for pension benefits for retirees with a full contribution period, but who are below 65 of age, is set at the legal subsistence minimum for people with lost working capacity.

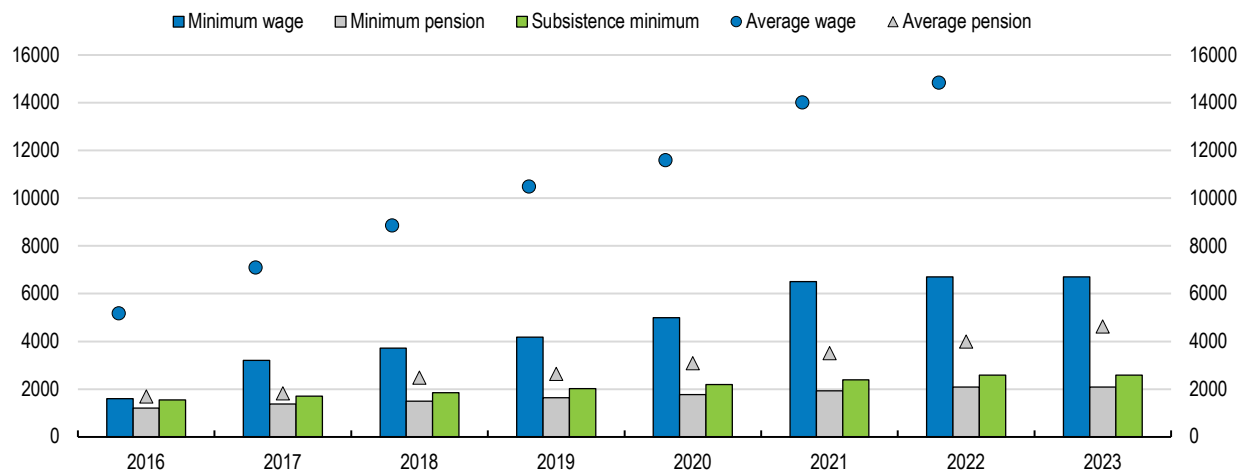
- For pensioners with full a contribution period and who are 65 or older, the floor is set at 40% of the minimum wage.
- Workers who have less than 15 years of contributions are not entitled to a pension but will receive social benefits., which in many cases will corresponds to the legal subsistence minimum for full-capacity workers.

Setting a sufficiently high minimum pension to secure pension adequacy entails reducing participation incentives. This can partly be offset by securing a strong link between contributions and pension benefits. However, there is also a cap on pension benefits, which is set at 10 times the legal subsistence minimum for people with lost working capacity, weakening the link between contributions and pension benefits.

Since the mid-2010s, the average pension has increased from being at par with the subsistence minimum to being twice as large, while the minimum pension has remained below the subsistence minimum (Figure 6). Pension benefits are adjusted annually based on a simple average of consumer price increases the previous year and the preceding three years' wage growth – a rule that over time will tend to increase purchasing power of pension benefits, but also widen the spread between average pension benefits and average wages. In addition, the minimum pensions have political determined indexation, leading a widening of their spread to average wages and pension benefits. Benefits are also low in relationship to the International Poverty line (IPL) of USD 2.15 per day. Nearly 40 per cent of pensioners receive a pension that is equal to or lower than the IPL (Figure 7) (World Bank, 2023^[4]).

Figure 6. Pension benefits are low

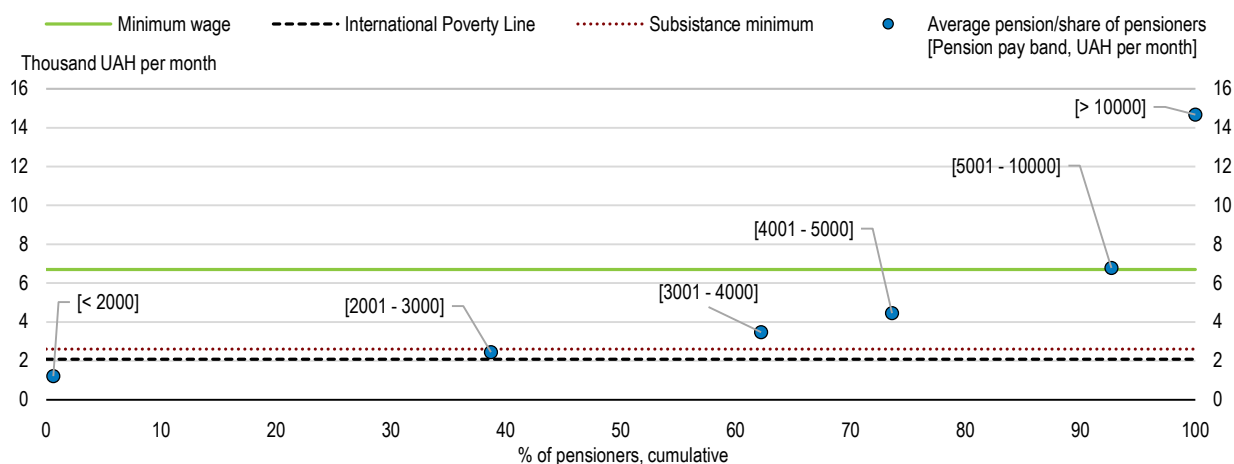
Hryvnia (UAH)



Source: State Statistics Service of Ukraine.

Notes: The subsistence minimum in this figure refers to the minimum for people who are able to work. In contrast, the minimum pension is equal to the subsistence minimum for people that are not able to work.

Figure 7. Most pensioners receive benefits that are well below the minimum wage



Source: Pension Fund of Ukraine; World Bank; Parliament of Ukraine; and OECD calculations.

Note: The International Poverty Line here is converted into monthly income in hryvnias (IPL = USD 2.15 * 30 * 32.34 (the average hryvnia/dollar exchange rate for 2022) = UAH 2,086

The high share of pensions with low pension benefits – reflecting low contributions and low minimum wages -- means that old-age poverty is widespread. At least two-third of all pensioners have benefits that are below the minimum wage income, and half of this group receive benefits that are below the subsistence minimum. Part of this reflects informality or the practice of “envelope wages”, as in many instances contributions are only made on minimum amounts of income, particularly for the self-employed, but also for employees. Applying the standard contribution rate to wage income (i.e., not including the income of the self-employed) indicates that actual SSC revenues are about a third lower than what could be expected.

Special pension regimes are numerous and underfunded

Several special pension regimes cover certain categories of public sector employees, people with disabilities and survivors (Table 1). The target groups are somewhat different from those in the OECD. Around half of the OECD countries have broad access to special pension schemes for workers in hazardous or arduous jobs, such as miners, while the other half have either no special provisions for such jobs, or provisions mostly limited to public safety and security jobs (Table 2. Occupational scope of pensions provisions for hazardous or arduous jobs in the OECD countries) (OECD, 2023^[5]). A common feature of special regimes, including in Ukraine, is that the enrollees are entitled to higher pension benefits and lower retirement ages than those in the general state pension system, implying a relatively large degree of underfunding, which is to be covered by the state budget. In Ukraine, enrolment in special regimes (excluding disability pensions) amounts to 11.3% of all retirees. In comparison, the OECD country with the highest enrolment in special regimes is Poland, where about 6% of all retirees are in special regimes. Also, the average age for drawing a pension in the Ukrainian special regimes is on average about 15 years lower than the statutory retirement age (Table 1).

Table 1. Special and other pension regimes have high enrolment, 2023

Special regimes for receiving pensions	The right to a pension, retirement age and pension calculation	Number of beneficiaries	Expenses under this regime (million. UAH)	Average age for entry into the regime
Disability pension	Full or partial loss of working capacity, subject to medical and social examination with regular re-examinations after the disability pension is granted.	1 439 783	60 390	46.5
Survivor's pension	Awarded to the dependents of the deceased, or non-working carers for the deceased's young children, less than 8 years old.	517 891	24 650	30.6
Military and police	For 25 years of service with benefits equal to 65% of the final pay. For each year of service over 20 years, an additional 3% accrual rate is granted, up to a maximum of 70% of the final pay. Survivors' pensions are at least 70% of the last salary for spouses. For other dependents, the benefits are an additional 50%. Thus, survivors' pension for a non-working spouse and two children reaches 170% of the last salary.	550 144	62 473	51.1
Victims of the accident at the Chernobyl Nuclear Power Plant (CNPP)	The disability pension due to the accident at the CNPP and the survivor's pension are calculated on the earnings received by workers in the exclusion zone in 1986-1990.	94 153	12 906	42.0
Prosecutors	Prosecutors with 25 years of service (of which 15 as a prosecutor) have pension benefits equal to 60% of the average of their last 60 months of pay. Survivor's pensions equal the deceased's benefits and 70% if more than two dependents.	5 979	1 548	47.1
Judges	After 20 years of service, regardless of age, retired judges receive half of their former pay. For each additional year of service, the accrual rate increases with 2%, but cannot exceed 90%.	3 594	4 148	55.4
Civil servants*	Civil servants hired before 2016 can retire at age 60 for women and 62 for men with 20 and 35 years of service, respectively, with pension benefits that are 60% of the average of the last 60 months of salary, with a ceiling of 10 times the minimum subsistence.	22 776	2 050	NA

Source: information of the Pension Fund of Ukraine provided by the Ministry of Economy of Ukraine.

Drawing a pension in one of Ukraine's special regimes is mostly dependent on a minimum length of service in an eligible profession. In contrast, in most OECD countries drawing a pension in a special regime mostly requires reaching a minimum age. In addition, there is often a requirement that a substantial part of the work career should be in the professions. As in Ukraine, many OECD countries use a combination of contributions and general pension revenues to finance the higher benefits in special regimes. In some cases, however, the financing is partially or fully separated from the general pension finances. Reforms in OECD countries have mostly been towards tightening access by simplifying and unifying pension systems across occupations. Typically, this has been done by removing or increasing the minimum age requirement for drawing pensions. Such reforms are often protecting incumbents by grandfathering existing rights.

Table 2. Occupational scope of pension provisions for hazardous or arduous jobs in OECD countries

Rules for workers starting their career in 2023

	Airline pilots	Ballet dancers	Electricians	Marine workers	Miners	Train drivers	Bus drivers	Nurses	Journalists	Teachers	Firefighters	Police	Military
Group 1: Broad access to pension provisions for hazardous or arduous jobs													
Austria	Y	Y			Y							Y	Y
Belgium	Y				Y	Y				Y	Y	Y	Y
Colombia	Y			Y	Y				Y	Y	Y	Y	Y
Chile													
Estonia	Y	Y	Y	Y	Y	Y	Y	Y		Y	Y	Y	Y
Finland													Y
France	Y	Y		Y	Y			Y			Y	Y	Y
Greece			Y	Y	Y	Y	Y	Y			Y	Y	Y
Italy	Y			Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Latvia		Y				Y					Y	Y	Y
Norway	Y	Y		Y				Y			Y	Y	Y
Poland	Y	Y	Y	Y	Y	Y	Y	Y		Y	Y	Y	Y
Slovak Republic		Y	Y		Y			Y			Y	Y	Y
Slovenia	Y	Y		Y	Y	Y	Y				Y	Y	Y
Spain	Y	Y		Y	Y	Y					Y	Y	Y
Türkiye					Y			Y	Y		Y	Y	Y
Group 2: Very limited scope of special provisions for hazardous or arduous jobs													
Czech Republic					Y						Y		
Germany					Y								
Hungary			Y		Y								
Japan					Y						Y	Y	
Korea				Y	Y								Y
New Zealand	Y					Y					Y	Y	Y
Portugal	Y	Y			Y						Y		
Group 3: Provisions for hazardous or arduous jobs only for some public safety and security jobs													
Canada											Y	Y	
Costa Rica													Y
Israel												Y	Y
Ireland											Y	Y	Y
Luxembourg												Y	Y
United Kingdom											Y	Y	Y
United States											Y	Y	Y

	Airline pilots	Ballet dancers	Electricians	Marine workers	Miners	Train drivers	Bus drivers	Nurses	Journalists	Teachers	Firefighters	Police	Military
Group 4: No provisions for hazardous or arduous jobs													
Australia													
Denmark													
Iceland													
Lithuania													
Mexico													
Netherlands													
Sweden													
Switzerland													

Note: In Chile almost no occupation is explicitly covered, but the rules allow many jobs to be covered based on work characteristics. In Finland the "years-of-service" scheme is closer to disability as it requires medical certificate about reduced capacity to work and a confirmation of having worked in arduous or hazardous jobs. Also in Denmark, the "seniority pension" scheme requires certificate of reduced work ability. Latvia has only these two occupations, but many public servant occupations are also covered. In Germany and Korea, police officers and firefighters are covered by the general pension scheme for civil servants and, thereby, they are not considered as being covered by special pension provisions for hazardous or arduous jobs.

Source: OECD (2023) Pension at a Glance, 2023

Access to the disability pension system is cumbersome

In 2021, disability pension enrolment stood at 1.4 million persons. Since the beginning of the war, despite media reports of large increases in the number of people with disabilities, the share of disability pension to total pension recipients has only increased marginally to 14.2% in early 2023 (ukrinform, 2023^[6]).

Access to disability pensions is hampered by substantial bureaucratic and time-consuming procedures (Overchuk, 2019^[7]). Enrolment is granted by a medico-social expertise commission (MSEC). The right to receive a disability pension is confirmed through regular re-examinations every 1-3 years. The admission system, however, is faced with problems. This is particularly the case for disability pensions for mental disorders, as such cases involve stricter procedures or have restricted access. For example, for regulatory reasons soldiers with Post Traumatic Stress Disorders (PTSD) cannot be granted disability pensions. Moreover, the regular re-examinations are cumbersome as there is no electronic register of documents. In addition, the re-examination requirement is effectively in place for all, as very few are granted permanent disability status, leading to unnecessary re-examinations. Rehabilitation is lacking. Only a third of all people with disabilities receive rehabilitation services. This reflects that 42% of all disabled have no access to rehabilitation facilities. Another factor is that more than half of all people with disabilities are not informed about rehabilitation services. Only a third of all people with disabilities even have a plan for rehabilitation (The National Assembly of People with Disabilities, 2023^[8]). Corruption is also an issue with more than 30 corruption cases having been instigated in the five years before the war, typically concerning purchasing disability status, acceptance of forged medical documents, and creating obstacles to registration of disability (National Agency on Corruption Prevention, 2022^[9]).

The labour market inclusion of people with disabilities is weak. Social partners report that only few people with disabilities are employed (Ukrainian Newsportal, 2023^[10]). Thus, few people with disabilities can supplement their low pension benefits. The State Employment Service has less than 30 000 persons with disabilities registered and of these only few are helped into employment (State Employment Service, 2023^[11]). This limited inclusion reflects the lack of rehabilitation, but also weak inclusion of persons with disabilities in the education system and poorly developed retraining programmes, as only about 3 000 persons with disabilities per year benefit from retraining provided by the State Employment Service. Wage subsidies to support the integration of people with disabilities into the labour market are relatively small. Employers that hire persons with disabilities are entitled to a lower social security contribution of 8.41%

(for some NGOs, the rate is 5.5%). However, the reduction is only weakly related to the degree of disability (Ministry of Justice, 2011^[12]).

The government plans to reform the system of medico-social expertise commissions in 2025 to reduce the reliance on subjective evaluations and to implement the international classification of functioning, which would increase the focus on the functionality of disabled people – a measure that could facilitate the labour integration of people with disabilities. The overall aim of the reform is to simplify access to disability pensions and make the system more transparent, while enhancing inclusion opportunities. The latter, however, requires investments in rehabilitation, retraining and the development of inclusive infrastructure.

Box 1. International experience in managing pension challenges in a post-war context

Following the Yugoslav civil war, Croatia experienced runaway spending on pensions as veterans enrolled in the disability pension system, boosting overall enrolment by 40% (IMF, 1995^[13]) (Badun, 2017^[14]). Growing misuse of the disability system, including corruption, became a problem. Such issues have also been observed elsewhere. For example, in the United States, applications for PTSD disability compensation have reached historically high levels, some of which has been blamed on malingered PTSD (Post-Traumatic Stress Disorder) (McNally and Fruehc, 2013^[15]).

In Croatia, the high new enrollment problems were addressed through a tightening of screening stringency along with more regular recertification of disability (now every three years) and ad hoc controls as well as the introduction of a two-step entry assessment procedure, although the measures did little to reduce the overall number of enrollees.

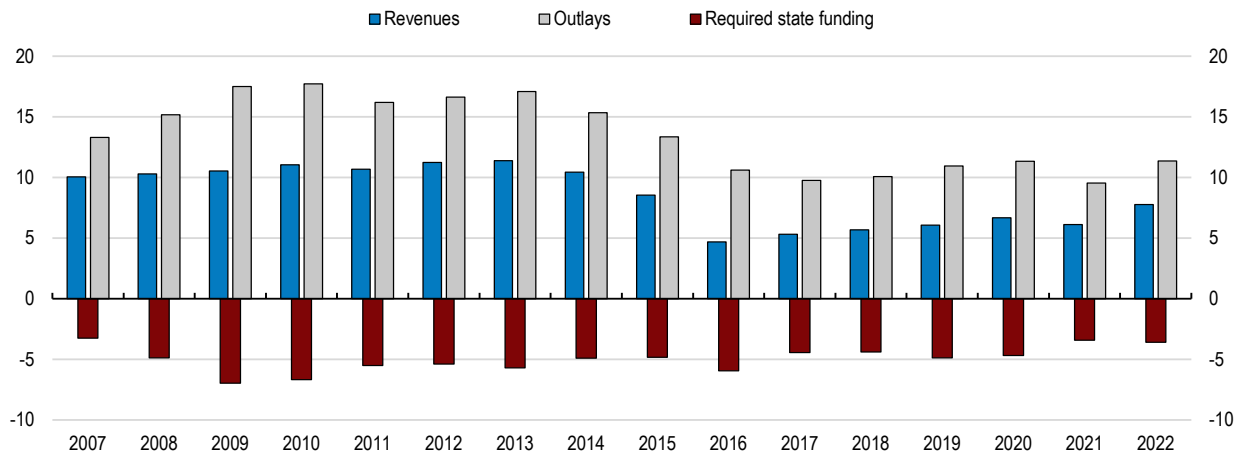
Broader reform was needed to constrain pension spending, including parametric reform to the Pay-As-You-Go pillar as well as the introduction of a second and third pillar. The broad parametric reform was focused on increasing the statutory retirement age, the minimum early retirement age, and the minimum contribution period, while lowering early pension benefits, widening the calculation period for benefits to include full career income, and reducing accrual rates. This was supplemented by replacing wage indexation with a partial wage and partial price indexation, although the minimum pension remained indexed to wages (Anusic, O'Keefe and Madzarevic-Sujster, 2003^[16]). These broad measures help to secure the fiscal sustainability of the Croatian pension system (The World Bank, 2023^[17]).

The pension system's deficit is set to increase substantially

The pension system has higher expenditures than contributions. In 2022, pension payments amounted to UAH 574 billion, 11.1 per cent of GDP, but total contributions were 40 per cent lower, leading to a deficit of 4.3% of GDP (Figure 8). However, the pension fund also receives transfers of 3.7% of GDP from the state to cover spending on the special pension regimes, leaving the fund with an overall deficit of 0.6% of GDP. This deficit is also covered by the state. Already before the war, the deficit was set to increase when only considering the projected increase in the old-age dependency ratio. For example, keeping average contributions and benefits at their current levels, but taking into account the UN's pre-war population projections, would lead to more than doubling the unfunded part of the Pension fund that the state budget would have to cover (United Nations, 2023^[18]) (Figure 9).

Figure 8. The Pension Fund needs large transfers from the state budget

Pension system accounts, as % of GDP



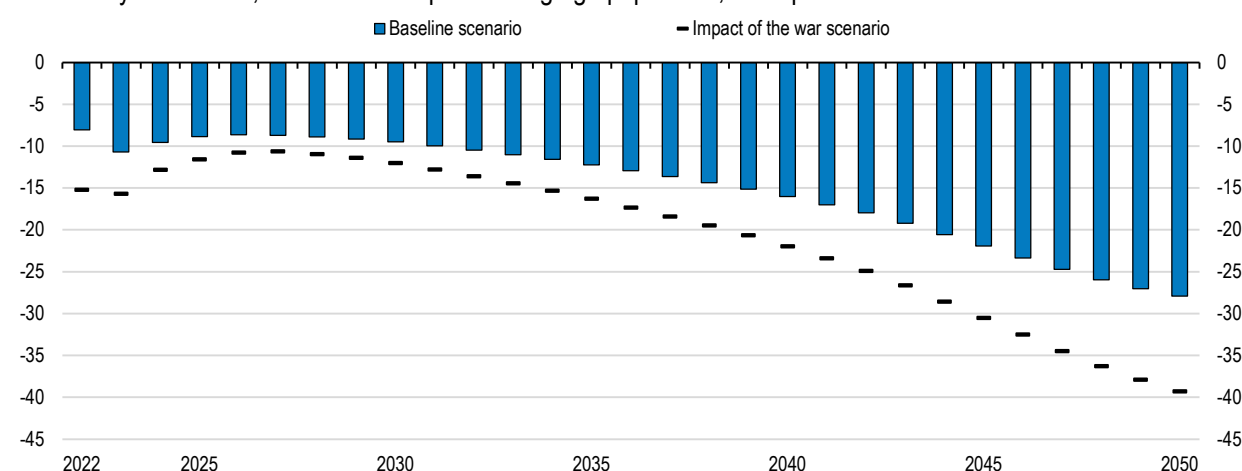
Source: Pension Fund of Ukraine.

The war has led the government to introduce a number of measures to protect pensioners' income. Notably, pension application and identity verification procedures have been simplified and made more flexible. Likewise, the procedure for paying SSC was also simplified and penalties for late payment, assessment, preparation, and submission of SSC reports were cancelled.

Aside from the impact of these measures, the war itself is having a profound negative impact on the sustainability of the pension system. This mostly reflects a negative impact on the population and its composition. Prior to the war, the UN estimated the population to be nearly 40 million. After the war commenced, 6 million are estimated to have left Ukraine, leaving the population at 34 million, although some institutes have even lower estimates (Ukrainian institute for the future, 2023^[19]). Most Ukrainian war refugees are working-age women and their children. Many of these may return after the war. Nonetheless, emigration is likely to have a negative impact on current and future labour supply and hence the contribution base. An additional and similar effect arises from the decline in the fertility rate to below 1 – an acceleration from the continuous decline since 2015 (when it stood at 1.5). Looking further ahead, higher enrolment in the special regime for military personnel and recipients of survivors' pensions and disability pensions are likely to boost benefit spending. All these factors put additional burdens on pension financing. Considering the effects of the war on population and beneficiaries, the unfunded part of the pension fund that has to be covered by the state budget, in real terms and measured per capita, could be fifty per cent higher in the long term (Figure 9).

Figure 9. The deficit in the pension system is set to widen

Pension system deficit, thousand UAH per working age population, 2022 prices



Source: OECD calculations.

Notes: the baseline scenario is based on the UN population projections and assumes constant average pension benefits and contribution rates in 2022 prices. The population projection in the war scenario assumes that three-quarter of all refugees who left Ukraine will gradually return over five years. Moreover, it is assumed that the war entails 50 thousand deceased and 75 thousand disabled individuals.

Policy reform options

Possible reform of the pension system to improve fiscal sustainability could include extending working lives, expanding the contribution base by reducing informal market activities and special regimes, increasing contributions, reducing benefits or improving their targeting. However, the scope for reducing benefits is limited by their already low levels and the prevalence of old-age poverty in the country. The contribution base can be widened by promoting longer working lives and ensuring that all workers contribute to the system. This could also allow raising benefits from current low levels, although additional measures would be needed to secure liveable minimum pensions. If all workers contribute, then targeting of benefits would improve as they become better aligned with contributions.

Asset-based pensions systems have grown in importance in the OECD. By 2022, the accumulated savings in asset-based pensions, with second pillar pension systems being the most important, surpassed the value of GDP in seven OECD countries (OECD, 2023^[5]). Introducing a second pillar pension is complicated, both because of the war-induced reduction in incomes, but also as this would require the current generation of contributors to finance the benefits of existing pensioners as well as their own. However, an important advantage of a second pillar is the accumulation of pension funds over time, which would promote financial markets and hence private investments. Moreover, introducing asset-based pension plans would make it possible for higher income workers to secure complementary pensions and bolster savings, while remaining the state pension system.

Many OECD countries have introduced various types of asset-based pensions systems, encountering various complex problems. Based on these experiences, the OECD has established a set of key considerations ahead of introducing such systems, including with respect to such diverse issues as the right institutional structures, appropriate governance to secure independence and expertise, how to manage shallow financial markets with insufficient diversity of financial instruments to secure an appropriate time structure of assets and liabilities, among others, tackling inflation risks to avoid erosion of asset values, how to protect assets, and how to build support for reform (OECD, 2022^[20]).

Policy options for safeguarding the pension system:

Promoting longer working lives:

- Increase gradually the statutory retirement age, for example to 65 as is the case in many OECD countries, and then link further increases to gains in life expectancy.
- Continue to increase the contribution period to be eligible for a full pension.

Raising enrolment in the pension system:

- Enhance enrolment incentives through better alignment of contribution and accrual rates by removing benefit floors and ceilings and abolishing gender differences in contribution periods for obtaining a minimum pension.
- Improve actuarial fairness in the system by using a single indexation method, i.e., aligning indexation methods of minimum pensions with old-age pension benefits. Also ensure that accrual rates are set so that they reflect contributions.
- Share the financing between employers and employees by introducing an employee contribution to the pension system, while reducing the employer contribution by a similar amount. This will give enrollees a direct stake in the funding, enhancing incentives for participation and for reducing informal economy activities.
- Introduce a pension calculator that provides easy access to information about future pension rights.
- Use career income as the basis for calculating benefits to strengthen the link between contributions and benefits and improve equity.

Securing liveable minimum pensions:

- Introduce a state-financed basic pension and use contributions to the Pension Fund to finance a top-up pension.
- Increase the minimum pension in line with consumer prices or another rule-based indexation system that at least maintain its purchasing value.

Reducing the high reliance on special regimes:

- Simplify and unify the special regimes by replacing the years of service requirement for receiving pensions benefits with minimum age requirements.
- Ensure that contributions suffice to cover accruals.
- Improve medical screening for accessing disability pensions to improve targeting.
- Introduce a two-step entry assessment procedure to reduce risks of corruption.
- Ensure that the annual recertification of disability results in good targeting.
- Improve training and reskilling opportunities to facilitate transfers of people with disabilities into the labour market.

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